No. 439

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CHARLES ELMORE CROPLEY
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Supreme Court of the United States

C. C. FLETCHER AND E. E. WAKEMAN, as surviving Trustees of the Standard Bentonite Company, a trust,
PETITIONERS,

vs.

FRANK G. CLARK, as Collector of Internal Revenue for the Collection District of Wyoming,
RESPONDENT.

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS, TENTH CIRCUIT

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MAY IT PLEASE THE COURT:

The petition of C. C. Fletcher and E. E. Wakeman, as surviving Trustees of the Standard Bentonite Company, a trust (hereinafter sometimes called "petitioners' trust"), respectfully shows to this Honorable Court:

I. JURISDICTION

The jurisdiction of this Honorable Court is invoked under Section 240 (a) of the Judicial Code, as amended by

the Act of February 13, 1925 (28 USCA 347), to review the judgment (R. 93) of the United States Circuit Court of Appeals, Tenth Circuit, entered July 5, 1945, in favor of respondent here (Appellee below), the mandate being stayed (R. 94) on petitioners' motion for a period of thirty days from August 9, 1945.

II. THE QUESTIONS

(1) Which is the proper test to be applied to determine whether a trust is taxable as an individual or as an association: (a) that applied by the Sixth Circuit in *Gibbs-Preyer Trusts Nos. 1 and 2* (1941), 117 Fed. 2d. 619; or, (b) the diametrically opposed test applied by the Tenth Circuit in the instant matter? (Conflict between circuits.)

(2) Does the United States have power to tax income actually from property held in trust as though it were the income of an association or corporation, in view of the command of Section 161 (a) of the Internal Revenue Code that "The taxes imposed by this chapter upon *individuals shall apply to the income . . . of any kind of property held in trust . . .*"? (Emphasis supplied.) (Unsettled and important question of Federal law.)

(3) Can it be said that a trust is a business trust and not a mere liquidating trust where, as here, the trustees converted corpus into cash (R. 26, 27) and are without power to invest or reinvest in other property? (Trust Instr., R. 6 to 10.) (Unsettled and important question of Federal law.)

(4) Do the decisions by this Honorable Court in *Helvering v. Coleman-Gilbert Associates* (1935), 296 U. S. 369 and companion cases in 296 U. S. mean that granted but admittedly unused powers (R. 26, 27), as in the instant case, permitting the trustees to engage in business, inevitably make the trust taxable as an association? (Probable conflict between Tenth Circuit and this Honorable Court.)

(5) Is it not possible for petitioners to act in a dual capacity under the provisions of their trust instrument (Trust Instr., R. 7), so that they are (a) *trustees* merely for the purpose of holding legal title to the trust corpus;

and, (b) are *agents* for the beneficiaries in performing every other act? (Probable conflict of Opinion below (R. 89) with *A. A. Lewis & Co. v. Commissioner* (1937), 301 U. S. 385.)

(6) Where, as here, the liability of the beneficiaries of a trust is not limited (R. 25); where, as here, certificates of beneficial interest in the trust are to be transferred only by a separate instrument executed with the formalities of a deed (R. 24); and where, as here, the interest of any beneficiary may be sold (R. 25) by the trustees in default of contribution by the beneficiary of his share of the expense of assessment work required to be done to hold title to the corpus; and where, as here, numerous other characteristics of a corporation are lacking (R. 25), is such a trust taxable as an association? (Probable conflict of Opinion below (R. 89) with *Morrissey et al. v. Commissioner* (1935), 296 U. S. 344.

(7) In the face of Section 161 (a) of the Internal Revenue Code, which says that the taxes imposed upon *individuals* "shall apply to the income of any kind of property held in trust" may petitioners' trust be taxed as an association on income exclusively from property held in trust (R. 26, 27), merely because of the existence in the trust instrument of unused powers? May it be classified and taxed because of what it did *not* do? (Probable departure from usual course of judicial proceedings.)

III. SUMMARY STATEMENT OF THE MATTER INVOLVED

The Findings of Fact by the trial Court (R. 22 to 27) are not disputed and references to the Record for facts will refer to the Findings, unless otherwise indicated.

This is a suit for refund of corporation income taxes for the calendar years 1940, 1941 and 1942, collected by respondent from petitioners' trust in the aggregate amount of $25,926.52 for the three years, respondents' theory being that petitioners' trust is a business trust, taxable as an association. (R. 22.) The Court below sustained respondent. (Opinion below, R. 89.)

Petitioners' trust was created in 1929 by a trust deed and agreement (R. 23), whereby eighteen individuals quit-claimed their several interests in six bentonite bearing placer mining claims located in Crook County, Wyoming (Trust Inst., R. 6), to C. C. Fletcher, L. F. Fletcher and E. E. Wakeman and their successors, as trustees, to hold title for the benefit of the eighteen grantors and their successors.

Petitioners have never operated the property (R. 27); they have never mined an ounce of bentonite (R. 27); they have no power to invest or reinvest and their powers and duties are strictly limited to the corpus originally conveyed to them in trust (Trust Instr., R. 7); the liability of the beneficiaries is not limited (R. 25); there is no provision for an office or other place of business, by-laws, minutes, books of account, meetings of beneficiaries, officers, employees, stationery or seal and never, during the entire life of the trust, have any such meetings been held or such business instrumentalities utilized (Trust Instr., R. 6 to 10; R. 25) transfers of shares of beneficial interest cannot be accomplished as are transfers of shares of corporate stock, but may be effected only by "the execution of an instrument of assignment executed in the manner required for the execution of deeds". (Trust Instr., R. 9.) The trust has never owned any mining machinery or equipment. (R. 27.)

Petitioners are empowered by the trust instrument "to manage and control the said property, to negotiate for the sale of and to sell, or to lease, to incumber, to contract for the development of, to mine upon, operate and develop the said property, or to otherwise handle or dispose of the said property or any part thereof to whom and upon such terms as the said trustees may deem best." (R. 24.) These powers are, however, coupled with an agency relationship between the trustees and the beneficiaries, for the trust instrument (Trust Instr., R. 7) continues: "and the said Trustees and their successors in trust are hereby made, constituted and appointed attorneys-in-fact for each of the parties hereto or their successors in interest."

The actual activities of the petitioners' trust (R. 26, 27) may be summarized as follows:

(a) From the date of its formation in 1929 to 1940 it did nothing but perform assessment work required by law to hold title to its placer claims.

(b) Beginning in 1940 and continuing into 1942, the trust entered into seven transactions (R. 26, 27). Three of these were sales of a specified number of tons of bentonite in place in the ground; one was a sale of bentonite in place in a described area of land; two were sales of a portion of the bentonite land as land; and the seventh and last transaction was a sale of the entire remainder of the land constituting the corpus of the trust. All were irreparable and final dispositions of trust corpus.

Such are the main facts in this controversy. On them the Court below held the income of petitioners' trust taxable as that of an association or corporation; not, however, because of what the trust did, but because of the powers granted in the trust instrument. In other words the tax was sustained below not because the Bentonite trust *actually* had income from operating a business, but because of granted but admittedly unused powers in the trust instrument.

IV. REASONS RELIED ON FOR ALLOWANCE OF THE WRIT

(1) *The United States Circuit Court of Appeals, Tenth Circuit, and the United States Circuit Court of Appeals, Sixth Circuit, are in head-on collision on the test to be applied to determine whether a trust is taxable as an individual or as an association.*

Tenth Circuit

" . . . it is now well settled that the character of an organization in respect to being formed for the promotion of business purposes must be determined by reference to the terms of the trust . . .; that parties are not free to say that the pur-

Sixth Circuit

"It is contended by the petitioner that it was not competent to controvert by parol testimony the plain terms of the written instruments creating the trusts and that the purpose of their creation and taxability must be determined from the language

pose was other or more narrow than that set forth in the trust instrument . . .; and that it is no escape from taxation as an association to say that all of the powers granted were not exerted in full measure." (*Opinion below*, R. 93.)

appearing in the instruments. *This concept must be rejected. The crucial test* in determining whether a trust is an association, taxable as a corporation *must be found in what the trustees actually do* and not in the existence of long unused powers." (Com. v. Gibbs - Preyer Trusts, Nos. 1 and 2 (CCA 6, 1941), 117 Fed. 2d. 619, 622, 623) (Emphasis supplied).

To the same effect: *Cleveland Trust Co. v. Com.* (CCA 6, 1940), 115 Fed. 2d. 481; Cert. Denied (1941), 312 U. S. 704.

(2) *The United States Circuit Court of Appeals, Tenth Circuit, has decided an important question of Federal law, which has not been but should be settled by this Honorable Court.*

(a) Section 161 (a) of the Internal Revenue Code, so far as material here, is as follows:

> "Sec. 161 (a). Application of Tax.—The taxes imposed by this chapter upon *individuals* shall apply to the *income* . . . of any kind of property held in trust . . ." (Emphasis supplied.)

The uncontradicted evidence in the entire record in the instant matter shows that the income upon which the disputed tax has been laid and collected is income "of property held in trust." Nor is there in the entire record a contrary finding or holding. Petitioners' contention in the Court below was that, *inasmuch as the taxable entity here involved is actually a trust;* and, because the record shows that *its income is actually from property held in trust*, as distinguished from income produced by the *operation* of a busi-

ness, it came squarely within the command of Section 161 (a), supra; and, consequently, that the only tax that the United States is empowered to collect from petitioners' trust is the same character of a tax that it would collect from an individual under the same circumstances. The Court below disposed of this contention by holding (Opinion below, R. 91, 92) that, because Section 901 (a) of the Internal Revenue Code defined the term "corporation" to include the term "association" and because petitioners' trust was held to be an association, Section 161 (a) had no application.

We submit that the question of whether or not the *substantive* provisions of law in Section 161 (a), relating to the taxation of income *actually* from property merely held in trust, are to be controlled by the *definition* of the term "corporation" in Section 901 (a), *is a question of law that should be settled by this Honorable Court.*

We submit that the income of a *true trust actually from property held in trust could not, because of Section 161 (a)*, be taxed as that of an association, even if the mode and form of the trust organization were similar to that of a corporation.

(b) Petitioners' powers and duties are limited by the trust instrument (R. 6) to the six placer mining claims originally conveyed to them in trust and thus every transaction here in view, whereby part of the trust corpus was converted into cash, was a step in the ultimate liquidation of said trust, petitioners being powerless to make other investments for the trust.

We submit that the question of whether or not a trust in the process of liquidation may be classified and taxed as a going, operating business association, with income from its business *operations*, is a question of law that has never been, but should be, settled by this Honorable Court.

(3) *The United States Circuit Court of Appeals, Tenth Circuit, has disposed of the instant matter in a manner probably in conflict with applicable decisions of this Honorable Court.*

(a) Since the decision of *Crocker v. Malley*, 249 U. S.

223, in 1919, down through the decision of *Morrissey et al. v. Commissioner*, 296 U. S. 344, and its companion cases in 296 U. S., decided in 1935, *this Honorable Court has never held a trust taxable as an association on income arising exclusively out of the mere holding of property in trust.* The income taxed as that of an association in all of such decisions has, *invariably*, been produced by the *operation* of a business enterprise and, thus, the provisions of Section 161 (a), Internal Revenue Code, have not been violated.

The record in the instant matter shows that the income of petitioners' trust, on which the disputed tax has been laid and collected, was, exclusively from the mere holding of property in trust and there is no evidence, finding or holding to the contrary.

(b) In *A. A. Lewis & Co. v. Commissioner* (1937), 301 U. S. 385, this Honorable Court held that where a tract of land, title to which was in a trustee, was subdivided and sold under the direction of a real estate agent, the trust was not taxable as an association. The record in the instant matter (R. 24) shows that the trustees of petitioners' trust were, by the trust instrument, "made, constituted and appointed attorneys-in-fact for each of the parties hereto and their successors in interest"; thus, we contend, creating an agency relationship between them and the beneficiaries, so that the trustees acted in a dual capacity: (1) As *trustees* they held legal title to the corpus of the trust; and, (2) As to every other act they were mere *agents* of the beneficiaries, by virtue of the powers of attorney above set out.

(c) In *Morrissey et al. v. Commissioner* (1935), 296 U. S. 344, this Honorable Court set out five characteristics of a trust that would, if present in a proper case, make the trust akin to a corporation, therefore making the trust taxable, if it were operating a business enterprise, as an association. One of those characteristics was limitation of personal liability of the benfieciaries to the property embarked in the undertaking. Another was transferability of shares of beneficial interest in a manner similar to that followed in transferring the shares of a corporation. In petitioners' trust the liability of beneficiaries is not so limited (R. 25;

Opinion below, R. 92) and certificates of interest may be transferred only by the execution of a separate instrument of assignment having the formalities of a deed (R. 24, 25). Another distinction between petitioners' trust and an association or corporation is that beneficiaries of petitioners' trust who fail to contribute their pro rata share of the expense of assessment work required to be done to hold title to the property (placer claims) constituting the corpus of the trust, may be "sold out" by the trustees acting under authority granted (R. 25).

(4) *The United States Circuit Court of Appeals, Tenth Circuit, has so far departed from the accepted and usual course of judicial proceedings, or has so far sanctioned such a departure by the trial Court, as to call for an exercise of the power of supervision by this Honorable Court.*

It is axiomatic in the judicial administration of the income tax laws of the United States that substance and not form is controlling; that men are taxed according to the results of the transactions into which they have entered; and that facts may not be gainsaid. But petitioners' trust is here held liable to the disputed tax, *not because of the exercise of powers granted in the trust instrument to operate the property, but because of the mere existence of those powers, admittedly unused.*

It is equally well settled that taxing statutes are not to be extended by construction beyond the plain meaning of their terms and that the command of a statute may not be disregarded. Yet the Court below has held petitioners' trust liable to tax as an association on income admittedly from property held in trust, despite the command of Section 161 (a) of the Internal Revenue Code that "The taxes imposed . . . upon *individuals* shall apply to the *income* . . . of any kind of property held in trust . . ." (Emphasis supplied.)

WHEREFORE, your petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals, Tenth Circuit, commanding that Court to certify and to send to this Honorable Court for its

review and determination, on a day certain to be therein stated, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, No. 3095, C. C. FLETCHER AND E. E. WAKEMAN, as surviving Trustees of the Standard Bentonite Company, a trust, Appellant, vs. FRANK G. CLARK, as Collector of Internal Revenue for the Collection District of Wyoming, Appellee, and that the judgment of said United States Circuit Court of Appeals, Tenth Circuit, be reversed by this Honorable Court and that your petitioners may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioners will ever pray.

C. C. FLETCHER AND E. E. WAKEMAN,
as surviving Trustees of the Standard
Bentonite Company, a trust,

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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 439

C. C. FLETCHER AND E. E. WAKEMAN, AS SURVIVING TRUSTEES OF THE STANDARD BENTONITE COMPANY, A TRUST, PETITIONERS

v.

FRANK G. CLARK, AS COLLECTOR OF INTERNAL REVENUE FOR THE COLLECTION DISTRICT OF WYOMING

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the District Court (R. 16–28) is reported at 57 F. Supp. 479. The opinion of the Circuit Court of Appeals (R. 89–93) is reported at 150 F. 2d 239.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 5, 1945 (R. 93), and an order staying mandate was issued on July 24, 1945 (R.

94). Petition for a writ of certiorari was filed on September 20, 1945. Jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Circuit Court of Appeals properly held that the so-called trust, here involved, is an association taxable as a corporation within the meaning of Section 3797 of the Internal Revenue Code.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 12–19.

STATEMENT

The facts taken from the District Court's memorandum opinion (R. 16–22) and from its findings of fact (R. 22–28) may be stated as follows:

C. C. Fletcher and seven others were the original locators of six placer mining claims. (R. 22–23.) Transfers of interests in the claims were made by the locators through C. C. Fletcher as attorney in fact. By October 31, 1929, there were 18 owners. (R. 23.) The interests were not of equal value. In order to equalize their interests and to provide for the handling of the entire group as a single tract the 18 owners decided to form a trust. The trust was formed by a trust deed and agreement on October 31, 1929. It speci-

fied that in order to "combine their separate interests in the * * * claims, so that each * * * [might] have and hold a beneficial interest in the entire group" and "for convenience in handling and operating" the claims, the individual owners by the deed created "an unincorporated association." (R. 23.) The association was to be known as, and to "do business" under the name of Standard Bentonite Company. (R. 23, Ex. A. R. 6.) Trustees were to hold title to and represent the interests of the beneficiaries "in all matters concerning the claims." (R. 17.) A provision followed by which the 18 owners quit-claimed to the designated trustees, C. C. Fletcher, L. F. Fletcher, and E. E. Wakeman, and their successors in trust, all of their "interest" in the six claims. (R. 23–24.)

Further provisions empowered the trustees (R. 24)—

> to manage and control * * *, to negotiate for the sale of and to sell, or to lease, to incumber, to contract for the development of, to mine upon, operate and develop * * *, or to otherwise handle or dispose of the * * * property, or any part thereof, to whom and upon such terms as the said trustees * * * [might] deem best * * *

They were also appointed attorneys in fact for "each of the parties * * * or their successors

in interest," and were given full authority to (R. 24)—

> execute any and all deeds, leases, contracts or other instruments affecting title to the * * * lands in their names as trustees * * * without naming any of the * * * holders of beneficial interest, * * * as grantors, lessors, or parties to any such deeds, leases, contracts or agreements.

Surviving trustees, in the event of the death, disqualification, or resignation of any of the trustees, were to have full power to act and to appoint a successor with the "approval of the holders of the majority of the beneficial interests in the trust." (R. 17.)

Provision was also made for the issuance of certificates of beneficial interest to the persons creating the trust in specified undivided fractional interests with rights to a proportionate share in the profits. (R. 17, 24, 25.) The interests were to be transferable by "instrument of assignment executed in the manner required for the execution of deeds." (R. 24–25.) By a further paragraph the owners of beneficial interests undertook to contribute a pro rata share to the expense of annual assessment work upon the claims and agreed that the trustees should be entitled to sell and dispose of such portions of the interest of a defaulting owner as should be necessary to raise his pro rata share. (R. 25.) The

agreement was made binding upon heirs, executors and assigns, and the duration of the trust was limited to 25 years. (R. 25.)

During the years 1929 to 1940 the taxpayers engaged in no activity except the performance of the assessment work necessary to hold the six claims. (R. 26.) Transfers of interests were made by the beneficial owners in accordance with the provisions of the trust deed and agreement. (R. 25.)

In 1940 the trustees executed four contracts for the sale of bentonite. Three of these — with Messrs. Messersmith and Materi, B. H. Thoeming, and Webster—provided for the sale of specified tonnage of bentonite in place at a specified rate per ton as mined. The trustees were required to remove the overburden and the vendees to perform the mining. The fourth agreement sold to the Wyodak Chemical Company "all of the merchantable deposits of bentonite" under a certain described area of the claims, payments to be made $20,000 upon signing of the contract, $15,000 on August 1, 1941, and $5,000 on August 1, 1942. (R. 26.)

In 1941 the trustees sold 60 acres of the land constituting the corpus of the trust to B. H. Thoeming for approximately $16,000. (R. 26.) And in 1942 they sold to B. H. Thoeming for approximately $24,000 part of claims 1 and 2 out of the corpus. (R. 26–27.) All of the remaining

corpus of the trust was sold to the Wyodak Chemical Company on August 6, 1942, for $225,000 (R. 27), to be paid $25,000 upon the execution of the agreement, $34,000 a year to 1948, and $30,000 on July 1, 1948 (R. 61–62). By a written instrument the beneficiaries indicated their approval of the contract. (R. 27.)

The Commissioner assessed deficiencies in income and personal holding company taxes, aggregating $25,926.52 (R. 16), for the years 1940, 1941 and 1942, which amount was paid by the taxpayers (R. 22). Both the District Court and the Circuit Court of Appeals approved the Commissioner's determination, holding that the Standard Bentonite Company was taxable as an "association" within the meaning of Section 3797 of the Internal Revenue Code.

ARGUMENT

The court below, affirming the District Court and the Commissioner, correctly concluded that the trust here involved was an association taxable as a corporation under Section 3797 of the Internal Revenue Code and the applicable Treasury Regulations (Appendix, *infra*). It properly applied the principles stated by this Court in *Morrissey* v. *Commissioner,* 296 U. S. 344, 361, that the character of an organization is to be determined by the terms of the trust instrument, and in *Helvering* v. *Coleman-Gilbert,* 296 U. S. 369,

374, that the parties are not at liberty to say that their purpose was other or narrower than that which they formally set forth in the instrument.

Petitioners assert that the decision below conflicts with that of the Sixth Circuit Court of Appeals in *Commissioner* v. *Gibbs-Preyer Trusts Nos. 1 & 2,* 117 F. 2d 619, as to the application of the above stated principles. The statement made by that court to the effect that the test, in determining whether a trust is an association, must be found in what the trustees actually do [1] rather than in the existence of unused powers, must be viewed in the light of the peculiar facts in that case and the actual basis of the court's decision.

In the *Gibbs-Preyer* case, the Board of Tax Appeals had found as a fact that there was a contemporaneous oral agreement between the parties to the written trusts to the effect that where the properties involved were managed by members

[1] In support of its statement the court cited (p. 623) *Gardiner* v. *United States*, 49 F. 2d 992 (C. C. A. 1st); *Dunbar* v. *Commissioner*, 65 F. 2d 447 (C. C. A. 1st); *Little Four Oil & Gas Co.* v. *Lewellyn*, 35 F. 2d 149 (C. C. A. 3d); *Tyson* v. *Commissioner*, 54 F. 2d 29 (C. C. A. 7th); *Willis* v. *Commissioner*, 58 F. 2d 121 (C. C. A. 9th); and *Commissioner v. Brouillard*, 70 F. 2d 154 (C. C. A. 10th). All of these cases were decided before this Court's decision in the *Morrissey* case, and as the court below stated (R. 93) in speaking of its own decision in the *Brouillard* case "it is no longer controlling on the question." Although the statement in the *Gibbs-Preyer* case was wholly incorrect, as a general principle, application for certiorari was unwarranted in view of the real basis of the decision.

of the family or beneficiaries, such persons would be considered as agents of the beneficiaries of the trusts, and that the properties had been consistently so managed. The Circuit Court of Appeals decision was actually based upon the theory that the terms of the written instrument, as to the trustee's powers, were not intended to and did not become operative so long as the properties were managed by members of the family or beneficiaries. The trustee's duties were purely ministerial. There is therefore no conflict between the *Gibbs-Preyer* decision and the decision below, nor with *Cleveland Trust Co.* v. *Commissioner,* 115 F. 2d 481 (C. C. A. 6th), certiorari denied, 312 U. S. 704, which is also distinguishable upon its facts.

Nor is the decision below in conflict with *Lewis & Co.* v. *Commissioner,* 301 U. S. 385. The different result in that case is also accounted for by the facts there involved, which distinguish it from the instant case. "The duties of the trustee were purely ministerial, with *no power* to control, direct, or participate in, the conduct of the selling enterprise contemplated by the contract." (Italics supplied, pp. 388–389.) Furthermore, since there was but a single beneficiary, there were no "associates" in that case.

While the petitioners assert (Pet. 3, 8) a probable conflict with the *Morrissey* case, they do not deny that the Standard Bentonite Company was

the result of an agreement whereby a number of individuals combined together in an "unincorporated association" for the purpose of realizing greater profits from the exploitation of mining claims by a pooling of individual interests. There is abundant evidence in the record of the commercial character of this enterprise which establishes clearly its role as a profit-making medium, rather than as a traditional trust, primarily intended for the conservation of property. The essential attributes of this trust closely resemble those of the corporate form enumerated in the *Morrissey* decision—the ownership, management and control of the property is centralized; the continuity of the trust is not affected by death among the beneficial owners or the trustees; interests were represented by transferable certificates of beneficial ownership.

As the court below pointed out (R. 92), the failure of the trust instrument to provide for limitation of personal liability of participants is not a conclusive factor, as was shown in *Pennsylvania Co. for Insurances, etc.* v. *United States,* 138 F. 2d 869 (C. C. A. 3rd), certiorari denied, 321 U. S. 788; *Nashville Trust Co.* v. *Cotros,* 120 F. 2d 157, corrected, 122 F. 2d 326 (C. C. A. 6th), certiorari denied, 314 U. S. 680; and *Kilgallon* v. *Commissioner,* 96 F. 2d 337 (C. C. A. 7th), certiorari denied, 305 U. S. 622. See, also, *Helvering* v. *Combs,* 296 U. S. 365, where this Court re-

ferred to the limited liabilities of the associates although no express limitation of liability was shown by the record.

The fact that the certificates of interest, in this case, were transferable only by execution of a separate instrument, is immaterial, for, as stated in the *Morrissey* case (p. 358) "the test of an association is not to be found in the mere formal evidence of interests or in a particular method of transfer."

Sections 161 and 162 of the Internal Revenue Code (Appendix, *infra*) are not applicable to this trust. Those sections and the Treasury Regulations interpreting them make it clear that they are not intended to embrace a trust created by the beneficiaries for the conduct of a business enterprise. Petitioners' assertion (Pet. 7) that "the income of a *true trust actually from property held in trust could not, because of Section 161 (a)*, be taxed as that of an association," obviously begs the precise question here involved, for both the District Court and the Circuit Court of Appeals held that this was not a true trust.

Finally, contrary to petitioners' contention (Pet. 6) this Court has passed upon the character of a trust in a case similar to the present one. In *Swanson* v. *Commissioner,* 296 U. S. 362, affirming 76 F. 2d 651, 653 (C. C. A. 7th) (a companion case to *Morrissey* v. *Commissioner, supra*), the taxpayers' contention was that the income of a trust

was taxable under Section 219 of the Revenue Act of 1926, which is comparable to Section 161 of the Internal Revenue Code. In that case active management of the property was not carried on by the trustees as such, but was turned over to a trustee acting in another and different capacity. Nevertheless, this Court held the trust taxable as an association.

CONCLUSION

The decision of the court below is correct; there is no conflict; no question is involved upon which this Court has not passed. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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OCTOBER 1945.

APPENDIX

Internal Revenue Code:

SEC. 161. IMPOSITION OF TAX.

(a) *Application of Tax.*—The taxes imposed by this chapter upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

* * * * *

(26 U. S. C. 1940 ed., Sec. 161.)

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by sec-

tion 23 (o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23 (o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;

(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its

taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary. (26 U. S. C. 1940 ed., Sec. 162.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(3) *Corporation.*—The term "corporation" includes associations, joint-stock companies, and insurance companies.

* * * * *

(26 U. S. C. 1940 ed., Sec. 3797.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.161–1. *Imposition of the tax.*—(*a*) *Scope.*—Supplement E (sections 161 to 170, inclusive) prescribes that the taxes imposed upon individuals by chapter 1 shall be applicable to the income of estates or of any kind of property held in trust. The rate of tax, the statutory provisions respecting gross income, and, with certain exceptions, the deductions and credits allowed to individuals apply also to estates and trusts.

The several classes enumerated and described in the four paragraphs of section 161 (a), and which are introduced by the word "including," do not exclude others which also may come within the general purpose of that subsection.

A guardian, whether of an infant or other person, is a fiduciary (see section 3797 (a) (6)), and, as such, is required

to make and file the return for his ward and pay the tax, or the return may be made by the ward. (See sections 19.51–1 and 19.142–2.) The estate of a ward is not a taxable entity, in that respect differing from the estate of a deceased person or of a trust.

The provisions of sections 161, 162, and 163 (relating to estates and trusts, fiduciaries, and beneficiaries) contemplate that the corpus of the trust, or the income therefrom, is, within the meaning of the Internal Revenue Code, no longer to be regarded as that of the grantor. If, by virtue of the nature and purpose of the trust, the corpus or income therefrom remains attributable to the grantor, these provisions do not apply. * * *

* * * * *

SEC. 19.3797–1. *Classification of taxables.*—For the purpose of taxation the Internal Revenue Code makes its own classification and prescribes its own standards of classification. Local law is of no importance in this connection. * * * The term "corporation" is not limited to the artificial entity usually known as a corporation, but includes also an association, a trust classed as an association because of its nature or its activities, a joint-stock company, an insurance company, and certain kinds of partnerships. * * *

SEC. 19.3797–2. *Association.*—The term "association" is not used in the Internal Revenue Code in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or partici-

pants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a declaration of trust, a statute, or otherwise. It includes a voluntary association, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an "investment" trust (whether of the fixed or the management type), an interinsurance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by whatever name known) which is not, within the meaning of the Code, a trust or an estate, or a partnership. * * *

SEC. 19.3797–3. *Association distinguished from trust.*—The term "trust," as used in the Internal Revenue Code, refers to an ordinary trust, namely, one created by will or by declaration of the trustees or the grantor, the trustees of which take title to the property for the purpose of protecting or conserving it as customarily required under the ordinary rules applied in chancery and probate courts. The beneficiaries of such a trust generally do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. Even though the beneficiaries do create such a trust, it is ordinarily done to conserve the trust property without undertaking any activity not strictly necessary to the attainment of that object.

As distinguished from the ordinary trust described in the preceding paragraph there is an arrangement whereby the legal title to the property is conveyed to trustees (or

a trustee) who, under a declaration or agreement of trust, hold and manage the property with a view to income or profit for the benefit of beneficiaries. Such an arrangement is designed (whether expressly or otherwise) to afford a medium whereby an income or profit-seeking activity may be carried on through a substitute for an organization such as a voluntary association or a joint-stock company or a corporation, thus obtaining the advantages of those forms of organization without their disadvantages. The nature and purpose of a cooperative undertaking will differentiate it from an ordinary trust. The purpose will not be considered narrower than that which is formally set forth in the instrument under which the activities of the trust are conducted.

If a trust is an undertaking or arrangement conducted for income or profit, the capital or property of the trust being supplied by the beneficiaries, and if the trustees or other designated persons are, in effect, the managers of the undertaking or arrangement, whether the beneficiaries do or do not appoint or control them, the beneficiaries are to be treated as voluntarily joining or cooperating with each other in the trust, just as do members of an association, and the undertaking or arrangement is deemed to be an association classified by the Internal Revenue Code as a corporation. However, the fact that the capital or property of the trust is not supplied by the beneficiaries is not sufficient reason in itself for classifying the arrangement as an ordinary trust rather than as an association.

By means of such a trust the disadvantages of an ordinary partnership are avoided, and the trust form affords the advantages of unity of management and continuity of existence which are characteristic of both associations and corporations. This trust form also affords the advantages of capacity, as a unit, to acquire, hold, and dispose of property and the ability to sue and be sued by strangers or members, which are characteristic of a corporation; and also frequently affords the limitation of liability and other advantages characteristic of a corporation. These advantages which the trust form provides are frequently referred to as resemblance to the general form, mode of procedure, or effectiveness in action, of an association or a corporation, or as "quasi-corporate form." The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other "officer," the use of a "seal," the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a "charter" or "by-laws," the existence of "control" by the beneficiaries over the affairs of the organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such classification, for the fundamental benefits enjoyed by a corporation, as outlined above, are attained, in the case of a trust, by the use of the trust form *itself*. The Internal Revenue Code disregards the technical distinction between a trust agreement (or dec-

laration) and ordinary articles of association or a corporate charter, and all other differences of detail. It treats such a trust according to its essential nature, namely, as an association. This is true whether the beneficiaries form the trust or, by purchase or otherwise, acquire an interest in an existing trust.

The mere size or amount of capital invested in the trust is of no importance. Sometimes the activity of the trust is a small venture or enterprise, such as the division and sale of a parcel of land, the erection of a building, or the care and rental of an office building or apartment house; sometimes the activity is a trade or business on a much larger scale. The distinction is that between the activity or purpose for which an ordinary strict trust of the traditional type would be created, and the activity or purpose for which a corporation for profit might have been formed.

Treasury Regulations 111, promulgated under the Internal Revenue Code, Sections 29, 161–1, 29.3797–1, 29.3797–2 and 29.3797–3, are identical with the above.

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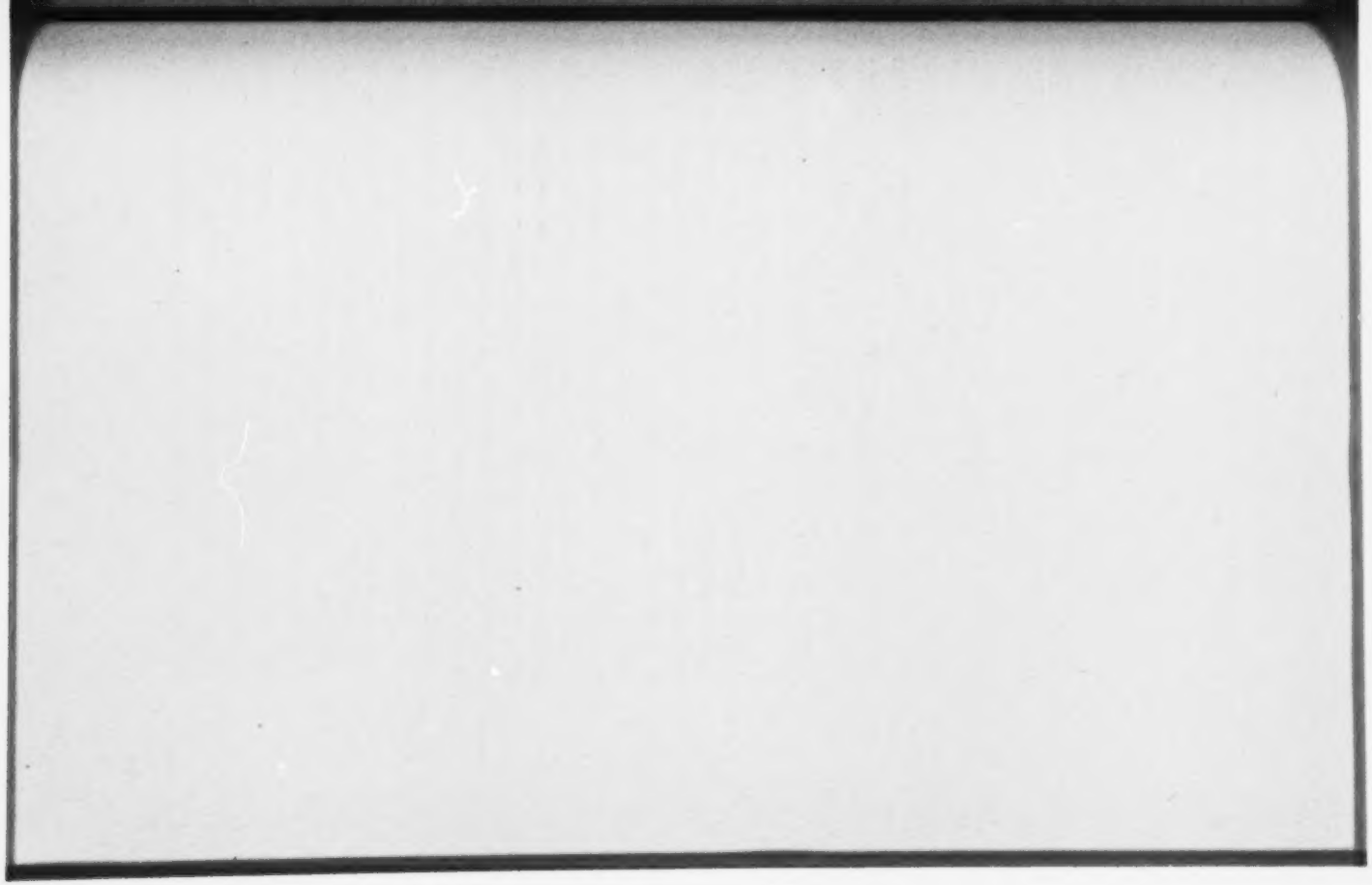

No. 439

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Supreme Court of the United States

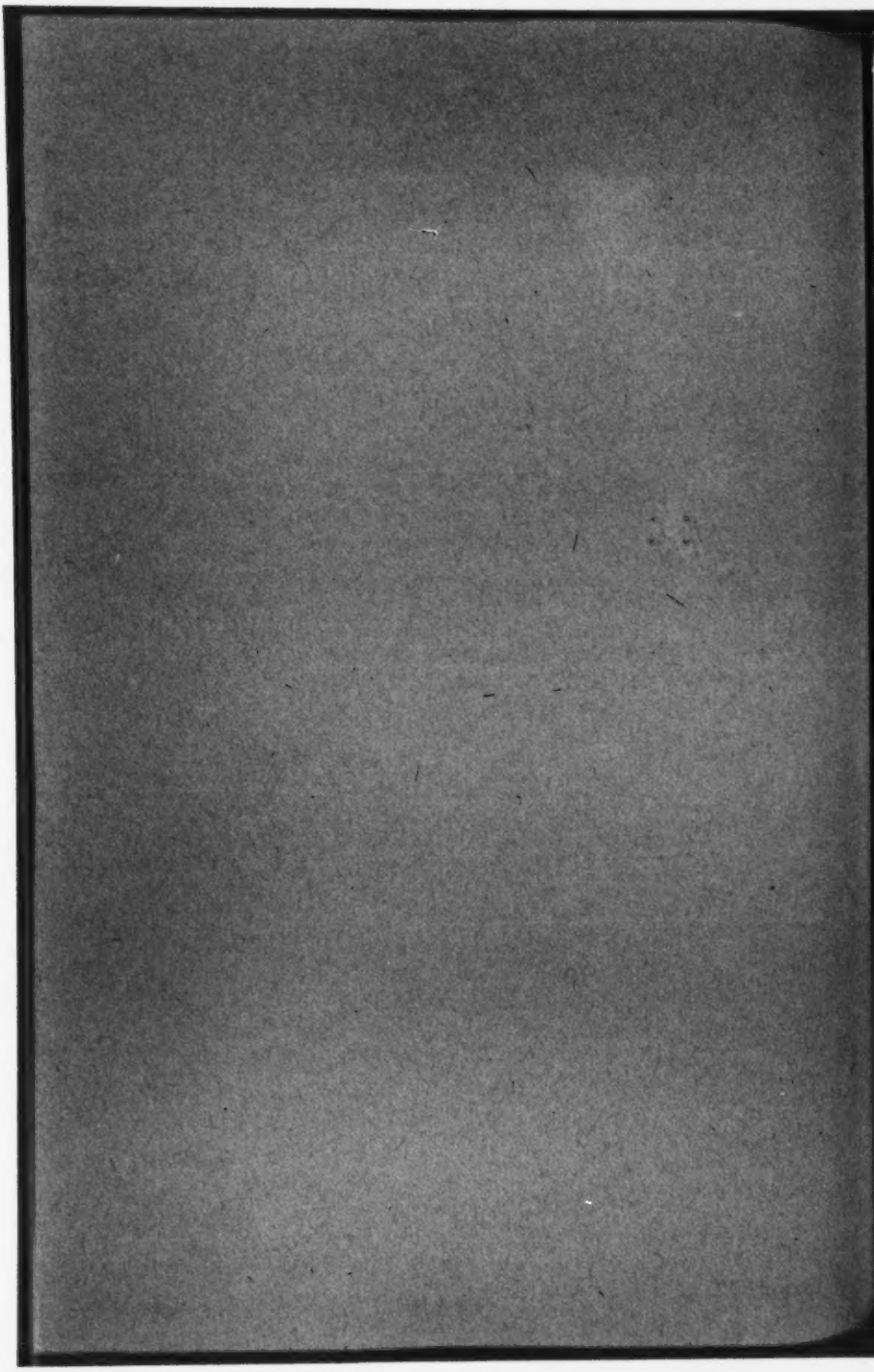
OCTOBER TERM, 1945

C. C. FLETCHER AND E. E. WAKEMAN, as surviving Trustees of the Standard Bentonite Company, a trust,
PETITIONERS,

vs.

FRANK G. CLARK, as Collector of Internal Revenue for the Collection District of Wyoming,
RESPONDENT.

PETITION FOR REHEARING UPON DENIAL OF PETITION FOR WRIT OF CERTIORARI



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C. C. Fletcher and E. E. Wakeman, as surviving Trustees of the Standard Bentonite Company, a trust, petitioners in this cause, respectfully present this, their petition for rehearing upon the denial of their petition for a writ of certiorari, heretofore filed herein, and submit the following reasons why this matter should be decided by this Honorable Court:

There are at least three questions in this case which are as new in this Honorable Court as tomorrow morning. They were neither raised nor settled in *Morrissey v. Commissioner* (1935), 296 U. S. 344. Nor were they raised or

settled in any of the companion cases decided the same day as the *Morrissey* case. Nor have they since been decided by this tribunal. Those questions are as follows:

I. Does the United States *have power*, under applicable tax statutes, to tax income exclusively from property held in trust, as the income of an association or corporation?

II. Does the mere existence in a trust instrument of a grant of power to the trustees to engage in business operations, *although never used*, make a trust, otherwise taxable as an individual, taxable as an association or corporation?

III. May a trust which was *actually in the process of liquidation* be taxed as an association or corporation carrying on a going, day to day business for profit?

We submit that these are serious questions and that the correct answers thereto are of importance not only to petitioners but to a great number of other taxpayers. They were not anticipated when the Morrissey and related decisions were handed down in 1935. And, as the United States, basing its action on the opinion below in petitioners' case, increases the range of its grasp to include other trusts situated like petitioners' trust, it seems reasonable to expect that a stream of other cases on these same issues, will arise and flow into this Honorable Court, until such time as the stream is dammed by an authoritative decision.

The questions will be discussed below in the order above set out.

I. Section 161 (a) of the Internal Revenue Code, so far as material here, says that "The taxes imposed by this chapter upon *individuals* shall apply to the *income* of . . . any kind of property held in trust." (Emphasis supplied.) There is no limitation or specification of the *kind of trust* which may derive income merely from the holding of property in trust and still be taxed on that income as an individual. The determining factor is *the kind of income.* Is it from *operating* a business? If so, it may be taxed as that of an association or corporation. Is it from "property held in trust"? *If so, it is taxed as that of an individual.*

The undisputed evidence in this case and the decisions below show that the income here taxed as that of an asso-

ciation or corporation *was exclusively from property held in trust.* Yet, despite Section 161 (a), it has been taxed as though it were not.

It is true that the Treasury Regulations give no effect to Section 161 (a) in this behalf and that the courts below have held that Section inapplicable in this case. It is equally true that the Treasury Regulations may neither expand nor change the law and that no part of the taxing statutes may be regarded as a nullity.

May Section 161 (a) be ignored in the circumstances here in view? Is it inapplicable in this and similar cases? Does the United States have power, despite the provisions of Section 161 (a), above noted, to tax income exclusively from property held in trust, as the income of an association or corporation?

There can be no authoritative answers given to these questions except by this Honorable Court.

II. This Honorable Court has never, in *Morrissey v. Commissioner* (1935), 296 U. S. 344, or in any of its companion cases, or in any other case, held that *unused* power to operate a business enterprise, granted the trustees in the trust indenture, made the trust taxable as an association or corporation. *In the Morrissey and related cases, powers granted the trustees to carry on business operations were exercised to the utmost extent. In petitioners' case such power was never used, even in the slightest degree.*

The courts below, in reliance upon the *Morrissey* and related decisions, held in petitioners' case that the mere *existence* in petitioners' trust instrument of power to operate the mining claims in view, *although admittedly unused,* was sufficient to make petitioners' trust taxable as an association or corporation. *In so holding the Tenth Circuit came into diametric conflict with the Sixth Circuit.*

It may not be assumed that the Sixth Circuit has overlooked the decisions by this Honorable Court in the *Morrissey* and related cases. On the contrary it must be admitted that the Sixth Circuit feels the compulsion of the *Morrissey* decision and its companion decisions in as high a degree as

does the Tenth Circuit. Indeed, both must consider themselves controlled by those decisions. Yet, in 1941, approximately six years after the Morrissey and related cases were decided, the Sixth Circuit held that the contention that "taxability must be determined from the language appearing in the instruments . . . must be *rejected*"; and that "The crucial test . . . must be found in what the *trustees actually do and not in the existence of long unused powers.*" (Emphasis supplied.) (*Commissioner v. Gibbs-Preyer Trusts Nos. 1 and 2*, (CCA-6, 1941), 117 Fed. 2d 619).

There can be only one reason for the conflict above noted. It is a difference in *understanding*, between the Tenth and Sixth Circuits of the rules of law to be gathered from the *Morrissey* and related decisions. Petitioners' case affords this Honorable Court an opportunity to reconcile the divergent views of these Circuits.

Which Circuit has applied the correct test, the Sixth or the Tenth? Does the mere existence in a trust instrument of power granted the trustees to carry on a business enterprise, *although never used*, make a trust, otherwise taxable as an individual, taxable as an association or corporation? What *are* the correct rules of law, pertinent here, to be gathered from the *Morrissey* and related decisions?

Until this Honorable Court decides these questions, citizens must remain in the dark.

III. The trust involved in the *Morrissey* case ". . . was not a liquidating trust; . . ." (p. 361). Petitioners' trust *was* a liquidating trust. The uncontradicted evidence in the record shows that the very income here taxed resulted exclusively from seven sales of the trust corpus, the seventh sale being of the entire remainder of that corpus. Thus, like a human being who, with every breath he draws, advances that far towards the grave, petitioners' trust was, as the result of every transaction into which it entered, that much nearer extinction. The record supports this assertion for it shows that petitioners, as Trustees, had no power to invest in other trust property. Their authority existed only with respect to the six bentonite mining claims originally conveyed to them in trust. As corpus was converted into cash,

they had no authority to do anything other than distribute the cash. Here, certainly, is a situation that not only did not exist in the *Morrissey* case, but is one which was excluded from the effect of the *Morrissey* decision by this Honorable Court itself. ("It was not a liquidating trust. . ." p. 361.)

May a trust which was *actually in the process of liquidation* be taxed as an association or corporation carrying on a going, day to day business for profit? This question was not in the *Morrissey* and related cases. Petitioners raised it below, but it was neither answered nor mentioned in the decision by the Tenth Circuit Court of Appeals. *It is still in this case and will, no doubt, arise time and again in many other cases.* What is the authoritative answer? Petitioners do not know. Others do not know. Until this Honorable Court speaks, taxpayers can only guess.

WHEREFORE, your petitioners respectfully pray that this Honorable Court recall its order of ~~October 5, 1945,~~ Nov. 5, 1945 denying their petition for a writ of certiorari to be issued to the United States Circuit Court of Appeals, Tenth Circuit, and issue said writ according to the prayer of their original petition herein.

C. C. FLETCHER AND E. E. WAKEMAN,
as surviving Trustees of the Standard
Bentonite Company, a trust.

By: GEORGE T. EVANS,
1229 First National Bank Bldg.,
Denver 2, Colorado.
COUNSEL FOR PETITIONERS.

I certify that the foregoing petition is, in my opinion, well founded and that it is not made for the purpose of delay.

GEORGE T. EVANS